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STATE FOR WHA/CAR (WBENT), WHA/EPSC (JSLATTERY)

SANTO DOMINGO FOR FCS AND FAS

TREASURY FOR L LAMONICA

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SUBJECT: JAMAICA RECORDS STRONG GROWTH DURING OCTOBER TO  
DECEMBER 2005

REF: 05 KINGSTON 2797

11. (U) Summary: The Jamaican economy weathered the storms of 2005 to record growth of 1.8 percent during the year. The expansion in output was largely due to robust growth of 4.1 percent during the final quarter, reflecting a recovery in agriculture and tourism. Declining oil and food prices also tamed inflation to 0.9 percent between October and December. However, fiscal challenges continued, with central government operations generating a deficit of USD 163 million (JMD 10.6 billion) due to lackluster revenue performance. The foreign exchange market also remained restless, with the exchange rate depreciating by 3.4 percent, despite a healthy stock of Net International Reserves (NIR). These difficulties aside, macroeconomic performance, led by economic growth, is expected to pick up in the first quarter of calendar year 2006. Real GDP is projected to grow by 3.1 percent, inflation is expected to moderate further, and relative stability should return to the foreign exchange market. The conclusion of the Peoples National Partys (PNP) internal elections and Standard and Poor's affirmation of Jamaica's 'B' long and short-term sovereign ratings should also help to sustain investor confidence in upcoming year. End summary.

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Solid - Rather Than Spectacular - Growth  
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12. (U) Driven by strong recovery in the agriculture and tourism sectors, real GDP for the December quarter jumped by 4.1 percent, the highest rate since the country  
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started estimating quarterly GDP in 1996. The result also brought growth for calendar year 2005 to 1.8 percent and while this was below the original target of 2-3 percent, it was still encouraging given the number of external shocks in 2005. Economic performance in the final quarter was largely due to a rebound in agricultural production (28.3 percent), which had suffered the most from adverse weather conditions. Construction (up 2.5 percent) continued to be buoyed by rehabilitation activities and hotel and highway projects. Manufacturing sector growth of 1.5 percent was largely due to the resumption of normal operations at the oil refinery (some analysts worried that disruptions in cement production caused by the hurricane season would hurt the sector). Miscellaneous services (up 13.2 percent) rallied, aided by a surge in tourist arrivals,

which reflected increased marketing and a diversion of visitors from hurricane-ravaged Cancun. The robust final quarter performance carried the tourism sector to a 4.5 percent growth in arrivals for 2005, the third consecutive year of increase. Transportation & Communication (up 6.4 percent) and Electricity & Water (up 4.5 percent) were other major contributors to growth.

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Inflation Trending Downwards  
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13. (U) Declining oil prices and the recovery in agriculture led to reductions in the price of fuel and agricultural products, which tamed inflation during the December quarter of 2005. Headline inflation was 0.9 percent or 1.7 percentage points below the average of the last five years and was also the lowest for the December quarter since 2000. The moderation during the quarter influenced a slowdown in the annual rate of inflation to 12.9 percent, compared to the annualized rate of 19 percent in September. Despite this dramatic slowdown, inflation was still above the nine percent target set at the beginning of the year and fuelled instability in the foreign exchange market, as investors realigned their portfolios to address the inflation concerns and the rates effect on the real rates of return for Jamaican dollar assets. Continued tightening of monetary policy in the United States also narrowed the interest rate differential between Jamaican and U.S. assets, making the latter more attractive. These factors combined with the uncertainty associated with the ongoing leadership race for the ruling People's National Party and the deterioration in the fiscal accounts placed increased

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demand pressure on the foreign exchange market. As a consequence, the local currency depreciated by 3.4 percent during the quarter. To satisfy the demand, the Bank of Jamaica sold US dollars to the market resulting in a USD 31.6 million decline in stock of NIR to USD 2.1 billion.

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Fiscal Difficulties Remain  
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14. (U) Influenced by lower-than-programmed revenue collections, GOJ'S operations continued to deteriorate, generating a fiscal deficit of USD 163 million (JMD 10.6 billion) during the review quarter. This was USD 152.3 million or JMD 9.9 billion more than budgeted and was due to revenues being USD 146.2 million below target. Expenditures were USD 7.7 million above target. As expected, the worsening fiscal position prompted the GOJ to push back its balanced budget objective to fiscal year 2007/08 (reftel). This could suggest that the administration is giving itself room to increase expenditure on social and capital projects during the next fiscal year, which is expected to be a general election year. (Note: The governing Peoples National Party (PNP) held an internal election on February 25 to choose the successor to Prime Minister P.J. Patterson, who has announced his intention to step down by the end of March. The winner, Portia Simpson-Miller, will contest a General Election with the Opposition Jamaica Labor Party no later than October 2007. End note.)

15. (U) Despite the fiscal strains, Standard and Poor's Rating Agency, in a report on February 17, maintained Jamaica's 'B' (stable) rating, noting that, "the ratings on Jamaica are supported by the government's ongoing commitment to fiscal discipline and debt reduction amid external shocks." The agency pointed to Jamaica's positive growth prospects, underpinned by robust foreign

investments in the tourism and mining sectors. It also cited the expected decline in the country's debt to GDP ratio to 127 percent as well as the reduction in interest costs due to declining domestic interest rates. Standard and Poor's also noted the close liaison Jamaica maintains with the IMF and the attendant policy transparency, which helps to preserve investors' confidence in the economy. Encouraged by the positive news, the GOJ was able to successfully float a USD 250 million global bond on the international market to pre-fund the borrowing program for 2006/07. The 30-year instrument is the longest ever floated by Jamaica and with a coupon rate of 8.5 percent, the lowest coupon offered on any GOJ instrument. Minister of Finance Omar Davies said that the reaction of the market demonstrated continued investor confidence in the management of the economy. Rating agency Moodie was also bullish on the issue suggesting that the success of the instrument will open up emerging market funds and more hedge funds would gravitate toward Jamaican debt as the capital market has a preference for longer-term securities.

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Comment  
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¶6. (U) The positive developments observed in the final quarter of 2005 are expected to continue during ¶2006. Real GDP is expected to rise by 3.1 percent during the first quarter, dominated by growth in the tourism, manufacturing and construction sectors. Strong tourism figures have carried into 2006, with arrivals in January jumping by 11 percent, one of the best monthly performances on record. Manufacturing GDP should accelerate with increased sugar output as well as a return to normal cement production levels. Influenced by increased infrastructure and hotel projects, the construction sector should continue to record strong growth. Inflation for the January to March quarter is expected to moderate to well under one percent, following the 0.2 percent outturn for the first two months of 2006. However, inflationary impulses could return, following a recent up-tick in oil prices, rental rates, insurance premiums and baked goods. The lagged effects of the

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depreciation in the exchange rate could also feed into inflation. Nevertheless, with inflation slowing and with the GOJ'S recent success in raising USD 250 million, relative stability should return to the foreign exchange market. GOJ operations are also expected to generate a fiscal surplus during the March quarter, as revenues typically soar to meet end-of-year tax deadlines. A confluence of the foregoing factors and Standard and Poor's rating affirmation could set the stage for relatively strong economic performance in 2006. However, these gains are dependent on a calm hurricane season and the maintenance of fiscal prudence leading up to the next general elections. End comment.

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